

No. 8/27/DPNP

Jakarta, November 27, 2006

CIRCULAR LETTER

To

ALL COMMERCIAL BANKS

IN INDONESIA

Subject : Prudential principles and Reports in the Application of
Consolidated Risk Management for Banks Performing
Control on Subsidiary Companies

Pursuant to Bank Indonesia Regulation Number 8/6/PBI/2006 dated January 30, 2006 concerning Implementation of Consolidated Risk Management for Banks Performing Control on Subsidiary Companies (State Gazette of the Republic of Indonesia Number 8 of 2006, Supplement to the State Gazette of the Republic of Indonesia Number 4602), Banks holding and/or performing control on Subsidiary Companies shall be required to apply a consolidated risk management.

In accordance with the aforementioned Bank Indonesia Regulation, the application of consolidated risk management for Bank performing control on Subsidiary Companies shall be implemented in stages. Initially, the application shall be conducted by submitting reports and calculating several ratios in the application of prudential principles.

Following ...

Following the enactment of the aforementioned Bank Indonesia Regulation, it is necessary to enact implementation provisions concerning prudential principles and reports in the application of consolidated risk management for Banks performing control on Subsidiary Companies in a Bank Indonesia Circular Letter as follows.

I. GENERAL PROVISIONS

1. Sustainability of the business of any Bank is affected by risk exposures arising either directly or indirectly from business operations of the Bank or of its Subsidiary Companies so that the Bank needs to apply a consolidated risk management.
2. In the application of consolidated risk management the Bank shall be required to comprehend its Subsidiary Companies' conditions and operational impacts on the Bank's entire conditions in detail. In this regard, the Bank must be able to identify, measure, monitor, and control risks arising from the Bank's and Subsidiary Companies' operations.
3. In addition to the monitoring of Subsidiary Companies' operational impacts on the Bank's entire conditions, it is necessary that the Bank also applies prudential principles on its Subsidiary Companies' operations in the same way as applied in the Bank business operations.

II. INFORMATION SYSTEM

Any Bank shall be required to hold systems which are able to identify, measure, monitor, and control entire business risks of the Bank and its Subsidiary Companies in order to be able to support the application of consolidated risk management effectively. This system is expected to be

able to ...

able to assist the Bank in implementing risk management of the Bank's and Subsidiary Companies' entire business. These systems at least include:

1. Accounting Information System

Any Bank shall be required to hold an accounting information system which must at least be able to create a consolidated financial report and other reports in the implementation of prudential principles. The application of consolidated financial reporting, including its methods and techniques, shall refer to applicable accounting standards. Meanwhile, the prudential principles which must be implemented by the Bank include but not limited to calculation of Minimum Capital Adequacy Requirement (CAR) on consolidated basis, rating of assets quality and establishment of allowances for assets losses (PPA) for the Bank and its Subsidiary Companies, calculation of Legal Lending Limit (LLL) taking into account of entire Bank's and Subsidiary Companies' exposures on consolidated basis, and the Bank rating on consolidated basis.

2. Risk Management Information System

In the application of consolidated risk management, risk management information system represents a part of management information systems to be held and developed as needed by the Bank, referring to applicable Bank Indonesia regulatory provisions concerning Application of Risk Management for Commercial Banks. As a part in the application of consolidated risk management, the risk management information system established by the Bank shall be capable to ensure :

- a. measurability of accurate, informative, and timely risk exposures, either composite risk exposures or by type of exposures adhered to Bank's and Subsidiary Companies' business operations, or risk

exposures of each type of functional activity of Bank and its Subsidiary Companies;

- b. compliance of application of risk management with established policies, procedures, and risk limits;
- c. availability of risk management application result/realization relative to its target on consolidated basis in accordance with policies and risk management application strategy.

III. CALCULATION OF CONSOLIDATED CAR FOR BANKS PERFORMING CONTROL ON SUBSIDIARY COMPANIES

In the application of consolidated risk management the calculation of consolidated CAR of a Bank and its Subsidiary Companies other than subsidiary companies conducting business in insurance as referred to in point IV shall be implemented under the following considerations.

1. Calculation of consolidated CAR shall be implemented by comparing consolidated capital with consolidated risk weight assets (ATMR).
2. Requirement of CAR calculation and fulfillment on consolidated basis shall not nullify Bank requirement to calculate and fulfill CAR on individual basis in compliance with applicable regulatory provisions concerning CAR.
3. Calculation and fulfillment of CAR on consolidated basis as referred to in number 1 shall take into account of credit risks and market risks.
4. Calculation of consolidated CAR by taking into account of market risks shall be in force for :
 - a. Any individual Bank which based on applicable provisions has been required to take into account of market risks in CAR

calculation; ...

calculation; or

- b. Any Bank which on consolidated basis holds securities position including share position and/or derivative transaction position in trading book equal or higher than criteria of securities position and/or derivative transaction position in trading book for a Bank which is required to take into account of market risks in CAR calculation in compliance with applicable Bank Indonesia regulatory provisions.

Consolidated CAR as referred to in number 1 shall be calculated as follows.

A. Capital Aspect

- 1) Consolidated capital comprises consolidated tier 1 capital plus consolidated tier 2 capital.
- 2) Components which may be categorized as tier 1 and tier 2 capital in the calculation of consolidated capital of Bank, including Subsidiary Companies, shall refer to applicable Bank Indonesia regulatory provisions concerning CAR.
- 3) Consolidated tier 1 capital shall have taken into account of shortfall of minimum Risk Based Capital (RBC) as referred to in point IV.2.b.2).
- 4) Consolidated tier 2 capital may only be calculated at a maximum of 100% (one hundred percent) of consolidated tier 1 capital.
- 5) Minority interest shall be categorized as tier 1 capital, except it contains any part not agree with component of tier 1 capital as referred to in applicable regulatory provisions concerning CAR for Commercial Banks.
- 6) Amount of minority interest which is categorized as tier 1 capital as referred to in number 5) may be not included in

consolidated...

consolidated capital by Bank Indonesia under several considerations including but not limited to :

- a) Bank shareholding in a Subsidiary Company at 50% (fifty percent) or less; and
 - b) no relationship/affiliation between other shareholder (minority interest) and Bank; or
 - c) no willingness of other shareholder (minority interest) to support Bank business group's capital as confirmed by a written statement or decision of Subsidiary Company shareholder general meeting.
- 7) Subsidiary Company's subordinated loans may be included into tier 2 capital in calculating Bank's consolidated CAR provided that they meet terms and conditions to be categorized as capital in compliance with applicable Bank Indonesia regulatory provisions concerning CAR. In order to be categorized as tier 2 capital, supporting data demonstrating fulfillment of all terms and conditions for subordinated loan shall be submitted by the Bank in compliance with applicable Bank Indonesia provisions.
- 8) If a Bank is required to take into account of consolidated market risk as referred to in point III.4, consolidated capital may be added with additional tier 2 capital. Calculation of consolidated tier 2 capital must meet criteria and requirements for additional tier 2 capital as referred to in applicable Bank Indonesia regulatory provisions concerning CAR taking into account of market risks for individual bank.
- 9) Calculation of consolidated capital must also take into account of subtracting factor in the form of Bank participation in any company which is not subject to requirement of application of consolidated risk management after deducted by special

reserves for PPA, except temporary capital participation in the framework of credit restructuring.

B. Risk Weighted Assets (ATMR)

Consolidated ATMR comprises consolidated ATMR for credit risk and consolidated ATMR for market risk.

1) Consolidated ATMR for credit risk

- a) Calculation of consolidated ATMR for credit risk shall refer to applicable regulatory provisions concerning CAR for individual bank.
- b) In calculating the consolidated ATMR for credit risk each consolidated assets item, including commitment and contingency liability items, shall be calculated based on risk weight in accordance with risk contents adhered to the assets concerned.
- c) Guidelines of calculation of the consolidated ATMR for credit risk shall refer to details of Appendix 5 Form I to this Bank Indonesia Circular Letter.

2) Consolidated ATMR for market risk

- a) Consolidated ATMR for market risk includes interest rate risk, exchange rate risk, and equity risk which is calculated by charging on capital. If a Bank or a Subsidiary Company conducts business based on sharia principles, the calculation of ATMR for market risk only includes exchange rate risk.
- b) Equity risk is loss risk arising from a change in price of equity position. Equity position includes position arising from share transactions, such as transactions of common stocks either with or without voting rights, convertible

securities ...

securities with characteristics of share, and commitment including option to purchase and sell shares, but does not include non-convertible preference shares.

- c) Consolidated ATMR for market risk shall be obtained from the multiplication of amount of consolidated capital charge for all kinds of market risks by 12.5 (twelve point five).
- d) Calculation of interest rate risk and exchange rate risk in consolidated ATMR for market risk and its requirements shall refer to applicable regulatory provisions concerning CAR taking into account of market risks.
- e) Calculation of equity risk in consolidated ATMR for market risk must be implemented by any Bank performing control on Subsidiary Companies with equity risk exposures. Calculation of risk equity includes specific risk and general market risk included in trading book.
- f) Capital charges for equity risk shall be calculated by summation of capital charges for specific risk and general risks.
- g) Equity positions included in equity risk are long position and short position included in trading book. Long position and short position must be calculated separately for any financial market where a Bank carries out share transactions.
- h) Long position and short position of equity may set off one another if those two positions are identical. Equity positions shall be considered identical if originate from a same issuer and traded in a same financial market.

Example: ...

Example :

A subsidiary company purchases PT X shares in the Jakarta Stock Exchange and the subsidiary company sells the shares of PT X under Forward contract in the Jakarta Stock Exchange. Those two positions may set off one another because they meet requirement of identical.

- i) Capital charges for equity risks shall be calculated separately, namely :
 - i. specific risk at 8% (eight percent) of gross equity position; and
 - ii. general risk at 8% (eight percent) of overall net position.

Example :

Company	Quantity of shares	Position	Market/ share price	Market price
A	10,000	Long	Rp100	Rp1,000,000
	2,000	Short	Rp100	Rp 200,000
B	15,000	Short	Rp200	Rp3,000,000
C	5,000	Short	Rp400	Rp2,000,000
D	10,000	Short	Rp100	Rp1,000,000
E	20,000	Long	Rp200	Rp4,000,000

- (a) Offsetting process for long position and short position in company A

$$\begin{aligned} & (10,000 \times \text{Rp}.100) - (2,000 \times \text{Rp}100) \\ & = \text{Rp}800,000 \text{ (Long)} \end{aligned}$$

(b) Amount ...

(b) Amount of long position

$$\text{Rp}800,000 + \text{Rp}4,000,000 = \text{Rp}4,800,000$$

(c) Amount of short position

$$\begin{aligned} &\text{Rp}3,000,000 + \text{Rp}2,000,000 + \text{Rp}1,000,000 \\ &= \text{Rp}6,000,000 \end{aligned}$$

(d) Specific risk

$$(\text{Rp}4,800,000 + \text{Rp}6,000,000) \times 8\% = \text{Rp}864,000$$

(e) General risk

$$(\text{Rp}4,800,000 - \text{Rp}6,000,000) \times 8\% = \text{Rp}96,000$$

(f) Equity risk

$$\text{Rp}864,000 + \text{Rp}96,000 = \text{Rp}960,000$$

The capital charge on consolidated equity risk resulting from the abovementioned calculation is Rp960,000.00 (nine hundred and sixty thousand rupiah). This capital charge shall be combined with capital charges on other market risks, such as capital charges on interest rate risk and exchange rate risk. Total capital charge on market risk shall be multiplied by 12.5 (twelve point five) to obtain a consolidated ATMR for market risk.

IV. APPLICATION OF RISK MANAGEMENT FOR SUBSIDIARY COMPANIES CONDUCTING BUSINESS IN INSURANCE

1. Consolidated risk management for Banks and Subsidiary Companies shall also be applied on Subsidiary Companies conducting business in insurance. The application of consolidated risk management for Banks holding and/or controlling Subsidiary Companies conducting business in insurance shall be implemented, among other things, by :
 - a. monitoring the fulfillment of minimum RBC ratio and other

prudential...

prudential principles stipulated by the supervisory authority;
and

- b. categorizing participation at Subsidiary Company conducting business in insurance as a subtracting factor in the calculation of Bank consolidated capital.
2. In calculation of consolidated CAR for a Bank holding a Subsidiary Company conducting business in insurance the Bank consolidated capital shall be calculated as follows.
- a. Bank participation at Subsidiary Company conducting business in insurance shall not be included in Bank consolidated ATMR.
 - b. If the Subsidiary Company conducting business in insurance fails to meet requirement of minimum RBC ratio stipulated by the supervisory authority,
 - 1) Bank participation at the Subsidiary Company conducting business in insurance shall be considered as a subtracting factor, namely at the amount of Bank participation at the Subsidiary Company conducting business in insurance after deducted by special reserves for PPA; and
 - 2) capital shortfall of Subsidiary Company conducting business in insurance to minimum RBC shall be categorized as a subtracting factor of tier 1 capital at 100% (one hundred percent), if the Subsidiary Company conducting business in insurance fails to meet the minimum RBC within the timeframe prescribed by the supervisory authority.
 - c. If the Subsidiary Company conducting business in insurance meets the minimum RBC requirement stipulated by the supervisory authority, the Bank participation at the Subsidiary

Company ...

Company conducting business in insurance shall be categorized as a subtracting factor of consolidated capital, namely at the amount of the Bank participation at the Subsidiary Company conducting business in insurance after deducted by special reserves for PPA.

V. ASSETS QUALITY RATING

Banks are required to conduct quality rating on Banks' and Subsidiary Companies' assets in establishing PPA. The establishment of PPA is intended that Banks' and Subsidiary Companies' financial reports may be properly consolidated, and consolidated CAR can be accurately calculated. Consolidated assets quality rating shall be exercised on earning and non-earning assets of Banks and earning assets of Subsidiary Companies in compliance with applicable Bank Indonesia regulatory provisions concerning Assets Quality Rating for Commercial Banks and Assets Quality Rating for Sharia Banks.

A. Earning Assets Quality Rating

1. If a Subsidiary Company holds assets which may be equalized to credit/financing at a Bank, assets quality rating by the Bank on Subsidiary Company's earning assets shall be based at least on promptness of principal and/or interest/margin/fee/profit share payments.
2. Based on the calculation in number 1, credit/financing quality shall be rated Current, Special Mention, Substandard, Doubtful, and Loss in compliance with applicable Bank Indonesia regulatory provisions concerning Assets Quality Rating for Commercial Banks and Assets Quality Rating for Sharia Banks.

3. If ...

3. If a Subsidiary Company holds assets which may be equalized to securities at a Bank, securities quality rating by the Bank shall refer to applicable Bank Indonesia regulatory provisions concerning Assets Quality Rating for Commercial Banks and Assets Quality Rating for Sharia Banks.
4. If a Subsidiary Company holds securities in the form of share, the share quality shall be rated by Bank as follows.
 - a. current, provided that the share is actively traded in Indonesian stock exchange and there are transparent information on market value.
 - b. if the share fails to meet criteria as referred to in letter a, the quality rating shall refer to stipulated quality rating for participation under cost method.
5. For earning assets in a Subsidiary Company performing as a finance company, earning assets quality rating by Bank shall be based on applicable regulatory provisions concerning earning assets quality rating and classification stipulated by the authorized institution on the Subsidiary Company.

B. Quality Rating on Other Earning Assets

Subsidiary Company earning assets other than those equalized to credit and securities shall be rated by Bank in compliance with applicable Bank Indonesia regulatory provisions.

C. Allowances for Assets Losses

1. Based on the earning assets quality rating as referred to in letter A and B, Bank shall be required to establish PPA either for Bank assets or Subsidiary Company earning assets in compliance with applicable Bank Indonesia regulatory provisions.

2. If ...

2. If the amount of PPA to be established on consolidated basis has not met requirements, the shortfall of PPA shall become a subtracting factor of consolidated tier 1 capital.

VI. LLL CALCULATION

Any Bank shall be required to monitor adequacy of funds taking into account of the fulfillment of CAR either for provision of funds by the Bank on individual basis or provision of funds by the Bank and its Subsidiary Companies on consolidated basis. Consolidated LLL is a maximum percentage of provision of Bank and Subsidiary Company funds permitted relative to consolidated Bank capital.

A. Limits of Provision of Funds

Referring to applicable regulatory provisions concerning the LLL for Commercial Banks, total portfolio of provision of funds for parties related to Bank shall be no more than 10% (ten percent) of Bank capital. In regard to calculation of consolidated LLL, the definition of provision of funds for related parties also include entire provision of funds of Bank and of Subsidiary Company relative to consolidated capital. The same regulation shall also be valid for provision of funds for borrowers of unrelated parties.

Consolidated LLL for provision of funds for borrowers of parties unrelated to Bank shall be established in compliance with applicable Bank Indonesia regulatory provisions concerning LLL for Commercial Banks, including but not limited to :

1. 1 (one) individual Borrower shall be at a maximum of 20% (twenty percent) of consolidated Bank capital; and
2. 1 (one) Borrower group shall be at a maximum of 25% (twenty five percent) of consolidated Bank capital.

In the ...

In the event of any violation or excess of consolidated LLL, Bank shall be liable to administrative sanctions referring to applicable Bank Indonesia regulatory provisions concerning the LLL.

B. Capital

In calculation of consolidated LLL, capital to be used shall be the consolidated capital of Bank. The consolidated Bank capital is a summation of consolidated tier 1 capital and consolidated tier 2 capital. The calculation of consolidated tier 1 capital and consolidated tier 2 capital shall refer to the calculation of consolidated CAR of the Bank. The consolidated Bank capital for the calculation of LLL shall not include additional tier 2 capital and shall not be deducted by participation.

VII. SUBSIDIARY COMPANY MANAGEMENT

1. Referring to Article 11 paragraph (3) Bank Indonesia Regulation Number 8/6/PBI/2006 concerning Implementation of Consolidated Risk Management for Banks Performing Control on Subsidiary Companies, Banks shall be required to submit a list of prospective executive board managing Subsidiary Companies proposed in shareholder general meeting.
2. At initial step a Bank shall submit a list of persons serving the management of its Subsidiary Company by the end of December 2006. A list of prospective management of the Subsidiary Company shall further be submitted no later than 10 (ten) working days prior to shareholder general meeting. The list of prospective management concerned shall be submitted by the Bank to Bank Indonesia under this address :

a. Related ...

- a. Related Directorate of Bank Supervision, Jl. M.H. Thamrin No. 2 Jakarta 10350, for a Bank with head office located in the working area of Bank Indonesia Head Office; or
- b. Local Bank Indonesia Regional Office, for a Bank with head office located outside the working area of Bank Indonesia Head Office.

VIII. REPORTING

Referring to Article 16 Bank Indonesia Regulation Number 8/6/PBI/2006 concerning Implementation of Consolidated Risk Management for Banks Performing Control on Subsidiary Companies, any Bank shall be required to submit Subsidiary Company's financial reports online referring to applicable Bank Indonesia regulatory provisions concerning Commercial Bank Monthly Report (LBU) or Commercial Bank Periodical Reports (LBBU). Insofar as online reporting still not possible, the Bank shall be required to submit reports offline on quarterly basis for the periods of March, June, September, and December.

A. Financial Report of Each Subsidiary Company

Any Bank which has not been able to submit its Subsidiary Company financial reports online through LBU or LBBU shall submit its Subsidiary Company financial reports referring to the format stipulated by respective supervisory authority.

If the Subsidiary Company is a company conducting business in insurance, the financial report concerned shall include report on calculation of RBC.

B. Consolidated Financial Reports

The presentation and format of consolidated financial reports shall refer to :

1. Appendix 1 : Consolidated Financial Report, Balance Sheet
2. Appendix 2 : Consolidated Financial Report, Profit Loss
Statement
3. Appendix 3 : Consolidated Financial Report, Commitments and
Contingencies

C. Consolidated Reports on Calculation of CAR and Details of ATMR

The presentation and format of consolidated reports on calculation of CAR and details of ATMR shall refer to :

1. Appendix 4 : Consolidated Report on Calculation of CAR
2. Appendix 5 : Consolidated Report on Details of ATMR

Calculation of ATMR for credit risks shall refer to calculation format in Form I, while calculation of ATMR for market risk shall refer to Form II.a and II.b, Form III, Form IV, Form V, and Form VI in Details of Appendix 5. The forms used by Bank in calculation shall be fully documented and, if necessary, Bank Indonesia may request results of ATMR calculated by the Bank.

3. Appendix 6 : Consolidated Report on Assets Quality and PPA

D. Consolidated Reports on Calculation of LLL

The presentation and format consolidated reports on calculation of CAR shall refer to :

1. Appendix 7 : Consolidated Report on Provision of Funds for
Parties Related to Bank
2. Appendix 8 : Consolidated Report on Excess/Violation of LLL
for Parties Unrelated to Bank

Abovementioned reports shall be submitted by any Bank since the reporting position of the end of December 2006 and shall be submitted no later than the 15th day of the second month after the end of the reporting month concerned.

For the ...

For the reporting position of the end of December 2006 in particular, the abovementioned reports may be submitted no later than the end of March 2007.

For any Bank conducting business based on sharia principles, the abovementioned reports shall be carried out in accordance with business characteristics of the Bank concerned and sharia principles.

IX. SANCTIONS

Referring to Article 17 Bank Indonesia Regulation Number 8/6/PBI/2006 concerning Implementation of Consolidated Risk Management for Banks Performing Control on Subsidiary Companies, any Bank failing to submit reports after the deadline of the report submission up to 14 (fourteen) working days after the deadline, shall be imposed a fine of Rp1,000,000.00 (one million rupiah) per working day of delay.

If a Bank has not submitted or submitted reports after the aforementioned deadline of the report submission, shall be imposed a fine of Rp50,000,000.00 (fifty million rupiah).

Any Bank which has not submitted the aforementioned reports shall be persistently required to submit the reports.

Example of calculation of sanction against a Bank which has not been able to submit report online :

Any Bank shall be required to submit Subsidiary Company financial report, consolidated financial reports (Appendix 1 up to Appendix 3), consolidated reports on calculation of CAR and details of ATMR (Appendix 4 up to Appendix 6), and consolidated reports on calculation of LLL (Appendix 7 up to Appendix 8) for the position as of the end of March 2007.

- a) Bank X submits the abovementioned reports in complete on May 14, 2007. Bank X is considered not late in submitting those reports

because...

because the deadline of report submission is no later than May 15, 2007.

- b) Bank Y submits Subsidiary Company financial report, consolidated financial reports, consolidated reports on calculation of CAR and details of ATMR, and consolidated reports on calculation of LLL on May 16, 2007. Bank Y shall be declared late in submitting reports for 1 (one) working day and be imposed a fine of Rp1.000.000,00 (one million rupiah).
- c) Bank Z submits Subsidiary Company financial report and consolidated financial reports on May 14, 2007 and consolidated reports on calculation of CAR and details of ATMR and consolidated reports on calculation of LLL on May 18, 2007. Bank Z shall be declared late in submitting reports because the reports it has submitted are not significantly complete, for 3 working days, and be imposed a fine of Rp3,000,000.00 (three million rupiah).
- d) Bank A submits Subsidiary Company financial report, consolidated financial reports, consolidated reports on calculation of CAR and details of ATMR, and consolidated reports on calculation of LLL on June 8, 2007. Bank A shall be imposed a fine of Rp50,000,000.00 (fifty million rupiah) because Bank A is considered fail in submitting reports or submits reports after the deadline of May 15, 2007, and more than 14 (fourteen) working days after the deadline of May 15, 2007, namely June 4, 2007.

The abovementioned imposition of fines shall come into force for all reports since the reporting position of the end of December 2006.

Provisions in this Bank Indonesia Circular Letter shall come into force since November 27, 2006.

For the...

For the public to be informed, it is ordered that this Bank Indonesia Circular Letter be promulgated in the State Gazette of the Republic of Indonesia.

Please be informed accordingly.

BANK INDONESIA,

MAMAN H. SOMANTRI
Deputy Governor